

VZCZCXRO1211
RR RUEHBC RUEHDE RUEHIHL RUEHKUK
DE RUEHGB #4058/01 3471806
ZNY CCCCC ZZH
R 131806Z DEC 07
FM AMEMBASSY BAGHDAD
TO RUEHC/SECSTATE WASHDC 4835
INFO RUCNRAQ/IRAQ COLLECTIVE

C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 004058

SIPDIS

SIPDIS

E.O. 12958: DECL: 12/13/2017

TAGS: [ECON](#) [EFIN](#) [IZ](#)

SUBJECT: DASH FOR DINARS AS DOLLAR DEMAND DROPS

Classified By: Economic Section Deputy James Freund, reasons 1.4 b,d

11. (C) SUMMARY: Demand for the dinar has risen this past week in response to the holiday period, a reported drop in imported good prices in Baghdad due to an appreciating dinar against the dollar and improved security, and speculation among money traders of a sudden appreciation of the dinar that occurred around this time last year. How the Central Bank of Iraq (CBI) handles growing demand for the dinar will be critical, especially in terms of expectations management and injecting dinar liquidity into the market. This is an encouraging development for Iraq and reflects a vote of confidence by Iraqis in their domestic economy and the government's monetary policies. END SUMMARY.

Surge in Dinar Demand

12. (C) Growing demand for dinars began showing up in the CBI's foreign currency auctions on December 9, when the CBI-listed market rate was 1,208 dinar per dollar versus the auction price of 1,216 dinar per dollar. On December 10 the CBI-listed market rate appreciated to 1,194 dinar per dollar and then on December 11 the CBI-listed market rate strengthened further to 1,175 dinar per dollar. We do not have anymore CBI-listed market rates, but a senior USAID consultant to the CBI told us on December 13 the rate among Baghdad money traders was hovering around 1,108 dinar per dollar. A senior Task Force for Business and Stabilization Operations (TF-BSO) consultant to the CBI confirmed with her contacts there that the CBI bought 45 million dollars and sold only 8.6 million dollars at the official auction price of 1,126 dinar per dollar. Another USAID consultant to Iraq's Central Office for Statistics and Information Technology (COSIT) said employees there believe the market rate could reach 1,000 dinar per dollar because today it is between 1,100-1,105 dinar per dollar. Finally, our local staff who are paid in dollars are complaining today of difficulty in finding money traders willing to take their dollars for dinars.

13. (SBU) In terms of background, the CBI maintained an official exchange rate from 2004-2006 of approximately 1,477 dinar per dollar. The CBI moved to appreciate the dinar through its foreign currency auction process in response to high summer 2006 inflation rates reaching 76.6 percent for August year-on-year (y-o-y). This auction process is managed and is also referred to as a "crawling peg" exchange rate. During the auction, the CBI invites banks to buy or sell dollars at rates based on a combination of its monetary policy and the effect of current market trends. The CBI has worked closely with the International Monetary Fund in designing and implementing monetary policy.

14. (SBU) Since September 2006, the dinar has appreciated approximately 17 percent against the dollar, while the dollar has declined by 12.6 percent and 6.9 percent against the euro and Pound Sterling respectively. At the beginning of 2007,

the exchange rate was 1,304 dinar per dollar. During December 12 trading, the CBI sell rate of 1,216 dinar per dollar reflected an appreciation of only 6 percent against the dollar for the major part of 2007. The slowing of appreciation likely reflects the impact of significantly reduced inflation for 2007, down to 15.5 percent y-o-y in November.

Confluence of Events Driving Dinar Demand

15. (SBU) Observations over the last three years have shown that prior to holiday periods, demand has been strong for dollars rather than dinars. Here we see a change in the trend, an increase in demand for dinars prior to the Eid holiday and the beginning of the Hajj. Eid al-Adha is a two day religious celebration starting on Wednesday, December 19.

Iraqis will have four days off with the weekend and due to improved security levels, a greater number of Iraqis are participating in the Hajj. The strong demand for dinars represents a vote of confidence by Iraqis in their domestic economy and the government's monetary policies.

16. (SBU) The dinar appreciation combined with better security conditions also likely are increasing dinar demand because dinar prices for goods appear to be beginning to drop in Baghdad. This is especially true for imported goods, which Iraqis are eager to buy. In a meeting today with staffers for the Council of Representatives Committees on Finance and Economic Affairs, they confirmed to econoffs that dinar prices for vehicles are declining. One staffer said two pickup trucks recently purchased for the Economic Committee were bought for a lower dinar price than when the purchase

BAGHDAD 00004058 002 OF 002

was previously considered.

17. (SBU) Another factor is that last year there was a substantial appreciation of the dinar against the dollar between November and the end of December, and money traders could be expecting this to happen again. A December 10 CBI press release announcing the withdrawal of the three lowest dinar denominated coins (dinar 25, 50, and 100) also could have further spurred speculation. Iraqi markets are not efficient or well integrated and prices are not well arbitrated--this means rumors can have big effects temporarily.

CBI Action Will Play Key Role

18. (C) COMMENT: How the CBI handles growing demand for the dinar will be critical, in particular on expectations management and injecting dinar liquidity into the market. The TF-BSO consultant notes the CBI is taking this situation very seriously, and when she was at the CBI this morning all the key managers were going to a meeting on the issue. She also said she had never seen such a long line of armored trucks snaking around the block waiting to get dinars in her entire three years consulting with the CBI. The CBI also issued an immediate press release today to dispel the rumors of sudden appreciation to 1,000 dinar per dollar or lobbying off any zeros to the exchange rate. The CBI's foreign currency auction's daily volume has fluctuated, but not substantially diminished.

19. (C) This is a good news story for Iraq, and the CBI is showing increased institutional capacity to respond to monetary issues. A stronger dinar is helping to curb inflation and imported goods are becoming cheaper for the average Iraqi as long as security continues to improve. Moreover, this gives the CBI a chance to continue to de-dollarize the economy; something that often is difficult to do in oil-rich countries. END COMMENT.

